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No. 85-1963

IN THE

Supreme Court Of The United States

OCTOBER TERM, 1985

TYLER PIPE INDUSTRIES, INC.,
Appellant

vs.

STATE OF WASHINGTON DEPARTMENT OF REVENUE,
Appellee

On Appeal from the Supreme Court of Washington

BRIEF OF APPELLANT

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November 20, 1986

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QUESTIONS PRESENTED

Sections 82.04.220 to 82.04.500, of the Revised Code of the State of Washington, impose a business and occupation tax upon persons engaged in, *inter alia,* wholesaling and manufacturing, measured by gross receipts received from the activity. Section 82.04.440 of the Revised Code provides an exemption from the manufacturing tax for persons engaged in manufacturing and wholesaling within the State of Washington.

The questions presented are:

1. Whether the tax imposed by these statutory provisions violates the Commerce Clause or the Due Process Clause of the United States Constitution, as applied to Appellant, because Appellant's connections with the State of Washington fail to satisfy constitutional standards with respect to sufficient minimal connection and substantial nexus?

2. Whether the Washington statutory scheme violates the Commerce Clause of the United States Constitution because the tax imposed discriminates against interstate commerce?

3. Whether the Washington statutory scheme violates the Commerce Clause or Due Process Clause of the United States Constitution because the tax imposed is not fairly apportioned, or is not fairly related to the services provided by the State of Washington, or is not rationally related to the values of Appellant in the State of Washington?

LIST OF PARTIES

The names of all parties to the proceedings below are reflected in the caption of the case. Pursuant to Supreme Court Rule No. 28.1, the Appellant, Tyler Pipe Industries, Inc., a Delaware corporation with its principal office in Tyler, Texas, states that it is a wholly-owned subsidiary of Tyler Corporation, a Delaware corporation with its principal place of business in Dallas, Texas. There are no other parent corporations, subsidiaries or affiliates of Appellant or Tyler Corporation other than wholly-owned subsidiaries of each.

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Tyler Pipe Industries, Inc., Appellant, appeals from the final judgment of the Supreme Court of Washington rendered in this case on March 6, 1986.

OPINIONS BELOW

The opinion of the Supreme Court of the State of Washington (Jurisdictional Statement, pp. A-1 to A-9) is reported at 105 Wn.2d 318 and 715 P.2d 123. The opinion of the Superior Court for Thurston County, Washington (Jurisdictional Statement, pp. B-1 to B-5) is not officially reported. The determination and final determination of the State of Washington Department of Revenue (Jurisdictional Statement, pp. C-1 to C-11) are not officially reported. The opinion of the Supreme Court of the State of Washington in the companion case of *National Can Corporation v. State of Washington Department of Revenue,* (Jurisdictional Statement, pp. D-1 to D-16) is reported at 105 Wn.2d 327 and 715 P.2d 128.

JURISDICTION

Appellant brought this action in the Superior Court of Thurston County, Washington, seeking a refund of business and occupation taxes imposed by the State of Washington. The Supreme Court of Washington entered and filed its opinion and judgment on March 6, 1986, denying the refund. Appellant filed a notice of appeal in that court on April 15, 1986. This Court noted probable jurisdiction by Order of October 6, 1986. Jurisdiction of this Court rests upon 28 U.S.C. Section 1257(2).

STATEMENT OF THE CASE

A. Proceedings Below.

On December 26, 1980, the Department of Revenue for the State of Washington assessed business and occupation taxes (hereinafter referred to as "B&O taxes") for the period January 1, 1976, through September 30, 1980, against Appellant, Tyler Pipe Industries, Inc. On February 25, 1981, Tyler Pipe petitioned the Department of Revenue to correct the assessment on the grounds that imposition of the taxes against Tyler Pipe violated the Due Process and Commerce clauses of the United States Constitution and the Federal Interstate Income Tax Act, 15 U.S.C. Sections 381 to 384. The Department denied the petition on March 12, 1981. Tyler Pipe filed an administrative appeal of the Department's action on March 31, 1981, which was turned down by the Department on April 30, 1981. Tyler Pipe then sought a temporary injunction in the Superior Court for Thurston County, Washington, against the Department's collection of the assessment on May 20, 1981. The Superior Court granted the injunction on June 8, 1981. On January 4, 1982, the Supreme Court of the State of Washington reversed the grant of the injunction. Tyler Pipe's motion for reconsideration was denied by the Washington Supreme Court on March 2, 1982.

On March 10, 1982, Tyler Pipe paid the tax assessment and sued the State of Washington in the Superior Court for Thurston County, State of Washington, for refund of the tax on the grounds that assessment and collection of the tax violated the Due Process and Commerce clauses of the United States Constitution and the Federal Interstate Income Tax Act. On June 15, 1984, the Superior Court filed a memorandum opinion holding against Tyler Pipe. On August 6, 1984, the Superior Court denied Tyler Pipe's motion for reconsideration, stating that the Court's decision in *Armco, Inc. v. Hardesty* is not controlling. On October 24, 1984, the Supreme Court entered Findings of Fact, Conclusions of Law, and Judgment.

On November 7, 1984, Tyler Pipe timely filed its Notice of Appeal to the Washington Supreme Court, raising as error each of the issues raised and rejected in the Superior Court. On March 6, 1986, the Washington Supreme Court filed its opinion affirming the Superior Court in all material respects.

On April 15, 1986, Tyler Pipe filed its notice of Appeal to the United States Supreme Court. Tyler Pipe filed its Jurisdictional Statement with the Court on May 30, 1986. By order dated October 6, 1986, the Court noted probable jurisdiction in Tyler Pipe's appeal. The Court also ordered this case consolidated for purposes of oral argument with the case of *National Can Corp v. State of Washington Department of Revenue,* No. 85-2006.

B. Statement Of Facts.

Appellant Tyler Pipe is a Delaware corporation with its principal place of business in Tyler, Texas. J.S. A-2; J.A. 16.[1] Tyler

[1]J.S. references are citations to pages in the Jurisdictional Statement filed by Tyler Pipe that reproduce the opinions of the lower courts in this case and the relevant statutes: pages A-1 through A-9 contain the opinion of the Washington Supreme Court, pages B-1 through B-15 the opinion and findings of the trial court, pages D-1 through D-16 the opinion of the Washington Supreme Court in the companion case of *National Can Corp. v. State of Washington Department of Revenue*, and pages G-1 through G-5 statutory provisions. J.A. references are citations to pages in the Joint Appendix filed by the parties in this case.

Pipe markets pipe and plumbing products nationwide. *Id.* Tyler Pipe is engaged in two lines of business relevant to this case: the marketing of Utility Division products and the marketing of DWV (drainage, waste and vent) Division products. J.S. A-2; J.A. 22-23.[2] All of the products marketed by Tyler Pipe in Washington in each line of business are manufactured by Tyler Pipe's wholly-owned subsidiaries in the State of Texas. J.S. A-2; J.A. 18, 23, 63-64.[3]

The Utility Division provides fittings and other products for utilities or public waterworks companies for the transmission of fresh water, and the DWV Division provides pipes, fittings and other products for installation in buildings to carry out waste water. J.A. 23-24, 30, 64-65, 75-81.[4]

Tyler Pipe was not engaged in business in the State of Washington. Tyler Pipe was not qualified to do business in the State of Washington, did not have an office or other place of business in the State of Washington, did not own any personal property or maintain any inventory in the State of Washington (except through the Wade Division)[5] and did not have any employees

[2]"Division" is the word used at Tyler Pipe to describe its different product lines. *See* J.A. 22-23, 28, 30, 46, 48, 52, 63. "Division" includes the marketing and sales activities of Tyler Pipe and the manufacturing activities of its subsidiaries with respect to a product line. *Id.*

[3]Tyler Pipe, through its wholly-owned subsidiary Wade, Inc., a Virginia corporation, also engages in a third line of business: the marketing of specification drainage products. J.S. A-2; J.A. 11-13, 23. Wade markets specification drainage products that it has purchased from outside manufacturers, as well as marketing specification drainage products manufactured by Tyler Pipe subsidiaries. J.A. 11. The Wade Division sales are not in issue in this case since the Washington B&O tax was paid on those sales. J.A. 12.

[4]The Wade Division provides drains and other devices which collect waste water within the building for introduction into the waste water system. J.A. 11-12, 23. Wade Division products are distinct from DWV Division products and are separately marketed. J.A. 113.

[5]Mechanical Agents, Inc., an independent sales representative for the Wade Division, did keep an inventory of Wade products on-hand in Seattle. J.S. A-2 through A-3.

located or active in the State of Washington. J.S. A-3; J.A. 30, 37, 40 and 97. Tyler Pipe did not send any personnel into the State of Washington for the purpose of soliciting or accepting orders from customers. J.A. 37. Tyler Pipe did not send any personnel into the State of Washington for the purpose of handling, adapting, designating or repairing any products. J.A. 37, 52. Products sold to Washington customers were shipped directly to the purchasing customer from Tyler, Texas by common carrier, and the purchasing customer was billed by mailed invoice from Tyler, Texas. J.A. 18, 32-33, 64-65. The customer paid Tyler Pipe directly; Tyler Pipe then credited the appropriate division (Utility or DWV). J.A. 18-20. Tyler Pipe did not send any materials or products into the State of Washington except by U.S. Mail or independent common carrier, and solicited sales in the State of Washington only through instrumentalities of interstate commerce, such as displays at national and regional trade shows, advertisements in national and regional trade magazines, and mailings of catalogues and other materials from Tyler, Texas. J.S. B-12, ¶ 15; J.A. 25-28, 29-32, 42-44, 59, 66-67.

Tyler Pipe also solicited sales through the services of Ashe & Jones, Inc., an independent contractor sales representative. J.S. A-2; J.A. 28-29, 94-95.[6]

Ashe & Jones, Inc. is a Washington corporation located in Washington State. J.S. A-2 and A-3. Neither Tyler Pipe nor any of its affiliates has had any ownership interest in Ashe & Jones. J.A. 17-18, 29. Ashe & Jones solicited sales for the Utility Division and for the DWV Division in the states of Washington, Oregon, Idaho, Montana and Alaska, and in Western Canada. J.A. 90, 96, 99, 111, 155. Ashe & Jones held itself out as a manufacturer's representative and solicited sales for other manufacturers, although it did not solicit sales for products that directly

[6]For most of Washington State, the Wade Division utilized a different sales representative from the Utility and DWV Divisions: Mechanical Agents, Inc. J.S. A-2. For a small part of southern Washington, sales for all three Divisions were solicited by Bridgeport Sales, Ltd. of Portland, Oregon. J.S. A-3; J.A. 146.

competed with the Utility Division or DWV Division products. J.A. 94-95, 101, 110, 112.

Ashe & Jones acted independently of Tyler Pipe. J.A. 18, 73, 111-112. Ashe & Jones was not under the supervision or control of Tyler Pipe, and did not receive any marketing, administrative or financial assistance or counselling from Tyler Pipe. *Id.*

The employees of Ashe & Jones were under the sole control of Ashe & Jones. J.A. 18, 111-112. Tyler Pipe did not issue instructions to these employees, did not train or educate them, did not supervise their performance, did not determine their compensation, and did not require them (or Ashe & Jones itself) to spend a minimum amount of time soliciting sales for Tyler Pipe. *Id.*

Ashe & Jones solicited sales of Utility Division products and DWV Division products from plumbing wholesale distributors. J.S. A-2; J.A. 103. The plumbing wholesale distributors, in turn, sold to plumbing contractors and water utilities. J.S. B-8, ¶3; J.A. 64, 75-76, 77, 130. Ashe & Jones also called upon architects, engineers and plumbing contractors to promote the sale of Utility Division and DWV Division products. J.S. B-10; ¶10; J.A. 102-103. Ashe & Jones received a commission on each sale of product in its territory, including the State of Washington, regardless of whether the sale order was delivered to Ashe & Jones for forwarding to Tyler Pipe for acceptance, or whether the order went directly to Tyler Pipe in Texas. J.S. A-3. Ashe & Jones was paid solely on a commission basis and received no other income or financial support from Tyler Pipe. J.A. 18.

Ashe & Jones did not accept any orders on behalf of Tyler Pipe. J.A. 33-36, 150 (¶4), 158. Ashe & Jones did not handle or collect the payments made for Tyler Pipe products. J.S. B-12, ¶61; J.A. 18-19. Ashe & Jones had no authority to bind or obligate Tyler Pipe. J.A. 153 (¶4); and see J.A. 33-36, 149-154, 158-159.

Of the total of approximately 8,336 sales orders received by Tyler Pipe from the State of Washington during the relevant period (excluding Wade), 44.96% were made directly to Tyler Pipe in Texas. J.A. 162. On a divisional basis, 100% of Utility Divi-

sions sales were through direct orders and some DWV Division sales were through direct orders. J.A. 69-72, 162.

In those cases when an order was given initially to Ashe & Jones for forwarding to Tyler Pipe, Ashe & Jones did not process or record the order, but merely relayed it to Tyler Pipe by telephone. J.S. B-11, ¶13; J.A. 19-20, 96. All the paperwork and processing with respect to an order was done by Tyler Pipe in Texas. J.S. B-11, ¶14; J.A. 19-20, 32-33, 36, 64-65. All orders, regardless of how transmitted, were subject to acceptance by Tyler Pipe in Texas. J.A. 33, 35, 36, 153 (¶4), 158. All shipments were direct from Tyler Pipe to the customer. J.S. B-12, ¶15; J.A. 18, 36, 59, 97. Ashe & Jones did not handle Tyler Pipe products. *Id.*

Ashe & Jones did not handle product complaints, receive payments for Tyler Pipe products, assist in collecting delinquent accounts, maintain inventory of Tyler Pipe products, or conduct advertising for Tyler Pipe. J.A. 96-97, 98.[7]

C. The Washington Business and Occupation Tax.

The Washington B&O tax is imposed at the rate of 0.44% upon gross receipts from the sale of products in the state. Wash. Rev. Code §§ 82.04.220 and 82.04.270, J.S. G-2 through G-3 and G-4.[8] The B&O tax is imposed on the seller, not the buyer, of the items. Wash. Rev. Code § 82.04.500, J.S. G-5. The B&O tax is described in the Code as a tax on the privilege of doing business in the State of Washington. Wash. Rev. Code § 82.04.220, J.S. G-2.[9]

[7]Ashe & Jones on occasion might have been contacted initially by a customer with a complaint or asked by Tyler Pipe if they knew anything about a slow paying customer, but such involvement, if any, was very rare and strictly incidental to Tyler Pipe's handling of these matters from Texas. J.A. 59-60, 62, 88-89, 91-92, 96-97, 104-107, 115-118.

[8]References to "Wash. Rev. Code" or to the "Code" are to the Revised Code of Washington (1974).

[9]Subsequent to the years involved in this case, the State of Washington enacted a surtax that increased the tax rate to 0.485%, although the retailing rate was increased only to 0.475%. See pages E-6 and E-7 of the Jurisdictional Statement in *National Can Corp. v. Department of Revenue*, No. 85-2006, the companion case.

The Washington B&O tax system imposes taxes (i) upon the activity of extraction of raw materials in the state, Wash. Rev. Code § 82.04.230, J.S. G-3, (ii) upon the activity of manufacturing in the state, Wash. Rev. Code § 82.04.240, J.S. G-3, (iii) upon the activity of making wholesale sales in the state, Wash. Rev. Code § 82.04.270, J.S. G-4, and (iv) upon the activity of making retail sales in the state, Wash. Rev. Code § 82.04.250, J.S. G-3. The taxes in issue in this case are wholesaling taxes imposed under Section 82.04.270 of the Code. Section 82.04.440 of the Code provides that persons engaged in two or more taxable activities shall be taxed upon each such activity, *except* that persons who are subject to the wholesaling or the retailing tax shall not also be taxable on their extraction and manufacturing in the state with respect to the same products sold within the state.

It is the exception from taxation provided by Section 82.04.440 of the Code for local sellers that causes the Washington B&O tax system to violate the Constitution. Section 82.04.440 provides an exemption from the extraction tax and the manufacturing tax for local taxpayers who sell their product at wholesale or retail in the state. That benefit is not available to wholesalers (such as Tyler Pipe) or retailers selling products extracted or manufactured out-of-state.

Ashe & Jones was subject to, and paid, a B&O tax of one percent on its commissions from the sale of Utility Division and DWV Division products. Wash. Rev. Code § 82.04.290, J.S. G-4 through G-5; J.A. 98. The plumbing wholesale distributors who purchase from Tyler Pipe are also subject to, and presumably pay, the Washington B&O tax on their resale of the products. Wash. Rev. Code § 82.04.270(1), J.S. G-4.

The Washington State Department of Revenue has assessed $130,010.56 in taxes and post-assessment interest against Tyler Pipe with respect to the sale of Utility Division products and DWV Division products in Washington for the period January 1, 1976, through September 30, 1980. J.S. A-1; J.A. 12.

Tyler Pipe (and its wholly-owned manufacturing subsidiaries) are subject to, and pay, substantial franchise and *ad valorem* taxes in the State of Texas, both of which taxes are based in part upon the value of the products and the assets utilized in the production and storage of the products sold to Washington customers. J.A. 37-38, 151, 160-161. The State of Texas does not currently impose a net income tax or gross receipts tax.

SUMMARY OF ARGUMENT

Appellant Tyler Pipe Industries, Inc. may not be taxed by Appellee State of Washington Department of Revenue, because the Washington Business and Occupation Tax system violates the Due Process Clause and Commerce Clause of the Constitution.

The Washington B&O tax is unconstitutional as applied to Tyler Pipe, because there is no nexus between Tyler Pipe and the State of Washington. Tyler Pipe is a Delaware corporation with its principal place of business in Tyler, Texas. Tyler Pipe has no office in the State of Washington and has no employees resident or active in the State of Washington. Tyler Pipe conducts no activities in the State of Washington. Tyler Pipe's sole connection with the State of Washington is that it solicits sales from its home office in Tyler, Texas, and through an independent contractor located in Seattle, Washington.

The Washington B&O tax discriminates against interstate commerce, because it provides an exemption to local sellers that is not available to out-of-state sellers. In *Armco, Inc. v. Hardesty*, the Court held that a West Virginia tax, identified both by the State of Washington in its *amicus curiae* brief and by the Court in its opinion as "similar" to the Washington B&O tax, unconstitutionally discriminated against interstate commerce for the same reason.

The Washington Business and Occupation Tax is not fairly apportioned, is not fairly related to the services provided by the state

and lacks a rational relationship to the values of interstate sellers, because it imposes an equal tax burden on interstate sellers with few local connections as it does on local sellers with many local connections.

For any one of the reasons that:

(i) there is insufficient minimal connection and no substantial nexus between Tyler Pipe and the State of Washington,

(ii) the Washington B&O tax discriminates against interstate commerce,

(iii) the Washington B&O tax is not fairly apportioned,

(iv) the Washington B&0 tax is not fairly related to services provided by the state, and

(v) the Washington B&O tax lacks a rational relationship to intrastate values,

the decision of the Washington Supreme Court should be reversed, and taxes paid by Tyler Pipe refunded.

I. THE CONSTITUTION PROHIBITS THE STATE OF WASHINGTON FROM IMPOSING ITS B&O TAX UPON TYLER PIPE, BECAUSE SOLICITATION OF SALES IN A STATE, WHETHER DIRECTLY OR THROUGH A LOCAL REPRESENTATIVE, IS NOT SUFFICIENT MINIMAL CONNECTION OR SUBSTANTIAL NEXUS TO ALLOW THAT STATE TO TAX THE SELLER.

The Due Process Clause of the Fourteenth Amendment to the United States Constitution (U.S. Constitution, Amendment XIV, Section 1) establishes two requirements that a state must satisfy in order to impose a tax upon the income of an interstate business: (1) there must be a "minimal connection" between the activities of the interstate business and the taxing state, and (2) there must be a "rational relationship" between the income attributed to the

state for tax purposes and the "values" of the business that are connected with the state. *Mobil Oil Corp. v. Commissioner of Taxes of Vermont,* 445 U.S. 425, 436-437 (1980); *Moorman Manufacturing Company v. G.D. Bair,* 437 U.S. 267, 272-273 (1978).

The Commerce Clause of the U.S. Constitution (U.S. Constitution, Article I, Section 8, clause 3) requires that a state may impose a tax upon an enterprise engaged in interstate commerce only if the tax (1) is imposed only upon an activity with a substantial nexus with the taxing state, (2) is fairly apportioned, (3) does not discriminate against interstate commerce, and (4) is fairly related to the services provided by the state. *Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274, 279, *rehearing denied,* 430 U.S. 976 (1977).

Although the requirements that a state tax must satisfy under the Due Process Clause and under the Commerce Clause are phrased differently, the requirements under the two Constitutional Clauses are closely related, and the tests for validity of a state tax are similar. *National Bellas Hess, Inc. v. Department of Revenue of the State of Illinois,* 386 U.S. 753, 756 (1967).

The Washington B&O tax, as applied to Tyler Pipe, is unconstitutional under both the Due Process Clause and Commerce Clause, because there is no minimal connection and no nexus between Tyler Pipe and the State of Washington.

The Court has long held that solicitation of sales in a state is not adequate grounds under the Constitution for a state to impose taxes upon an out-of-state seller because such taxes are impediments to interstate commerce. *Robbins v. Shelby County Taxing District,* 120 U.S. 489 (1887). In *Robbins,* the Court held that a Tennessee license tax imposed upon sales solicitors was an unconstitutional impediment, because it burdened the out-of-state sellers who wished to sell in the Tennessee market.

In *Norton Co. v. Department of Revenue of State of Illinois,* 340 U.S. 534 (1951), the Court elaborated on the standards established in *Robbins.* In *Norton,* a Massachusetts corporation contested the imposition of an Illinois gross receipts tax on certain of its Illinois sales. 340 U.S. at 535. The seller's manufacturing site and its management, accounting and credit offices were located in Worcester, Massachusetts, but it also had a branch office and warehouse in Chicago, Illinois from which sales were made. 340 U.S. at 535-536. Norton sold and delivered to Illinois customers (i) from the Illinois local office, (ii) from Worcester through the Illinois office, and (iii) directly from Worcester, bypassing the Illinois office. The seller conceded that the local sales made from its Chicago office and warehouse were subject to the Illinois tax, but asserted that sales made to Illinois customers from its Worcester location directly or through the Illinois office were exempt. *Id.*

The Court held the Worcester sales channeled through the Illinois office were so mingled with the seller's local Chicago business, that the seller was unable to show that the services of its Chicago branch office were not "decisive factors" in seller's establishing and holding the market; consequently, these "mingled" sales were subject to the State of Illinois tax. 340 U.S. at 538.[10]

The Court held that sales orders received in Worcester from Illinois customers and filled by shipment directly from Worcester to the Illinois customers were exempt from the gross receipts tax under the Commerce Clause, 340 U.S. at 539, notwithstanding the facts that the seller's local office provided engineering and technical advice to the Illinois customers, the local office provided services to the customers after the sale, the local office replaced

[10]For cases setting forth the extensive activity that is necessary to establish sufficient minimal contact and substantial nexus, see *General Motors Corporation v. Washington,* 377 U.S. 436 (1964) (involving a large local staff organization performing extensive sales and other operations in-state), and *Standard Pressed Steel Co. v. Washington Department of Revenue,* 419 U.S. 560 (1975) (involving an employee engaged in engineering and other services full-time in the taxing state).

defective machines and handled complaints, and the local office was the only source of the seller's customer relations in Illinois, 340 U.S. at 541 (Clark, J., dissenting). These "local incidents" to all of seller's sales were insufficient to cause sales direct from Worcester to the Illinois customer to be subject to Illinois taxation.

Tyler Pipe shipped all of its products direct to its customers in Washington by interstate carrier. Further, Tyler Pipe maintained no local office, inventory, or employees in Washington, as did Norton in Illinois. Tyler Pipe did not exercise any control over, nor did it involve itself in the day to day activities of, Ashe & Jones. Tyler Pipe did not provide local engineering and technical advice to Washington customers. It had no local office to provide services to customers after the sale. Tyler Pipe handled complaints from Texas, and replaced defective parts from Texas. Both were rare. There is no evidence that Ashe & Jones provided any of those services.[11] Thus, Tyler Pipe performed far *fewer* activities in Washington with respect to its direct sales than did Norton in Illinois with respect to its direct sales, so that all of Tyler Pipe's sales fall into the third category of nontaxable direct sales established in *Norton.*

Because Tyler Pipe has insufficient local connection with the State of Washington, under the rules established in *Norton,* the State of Washington is constitutionally prohibited from taxing Tyler Pipe on its Washington gross receipts.[12]

[11]All of the facts relied on by the Supreme Court of Washington to hold that Tyler Pipe had sufficient nexus in Washington were simply the sticks that make up the bundle of sales solicitation. Indeed the Supreme Court of Washington viewed the sales functions of Ashe & Jones as essentially identical to those of factory salesmen. J.S. A-3. That is precisely what *Robbins* and *Norton* say is not sufficient for nexus.

[12]Congress, in enacting the Federal Interstate Income Tax Act, has statutorially provided that similar standards must be applied in determining the extent of a state's power to impose net income taxes. The Act is silent as to gross receipts taxes. See the Appendix to this Brief.

II. THE CONSTITUTION PROHIBITS THE STATE OF WASHINGTON FROM IMPOSING ITS B&O TAX UPON TYLER PIPE, BECAUSE THE WASHINGTON B&O TAX (A) DISCRIMINATES AGAINST INTERSTATE COMMERCE, (B) IS NOT FAIRLY APPORTIONED, (C) IS NOT FAIRLY RELATED TO THE SERVICES PROVIDED BY THE STATE OF WASHINGTON, AND (D) LACKS A RATIONAL RELATIONSHIP BETWEEN THE INCOME OF TYLER PIPE THAT WASHINGTON STATE SEEKS TO TAX AND THE INTRASTATE VALUES OF TYLER PIPE.

The Washington B&O Tax does not comply with the "rational relationship" requirement of the Due Process Clause, nor with the nondiscrimination, fairly apportioned, or fair-relation-to-services requirements of the Commerce Clause. *Mobil Oil Corp. Commissioner of Taxes of Vermont, supra; Moorman Manufacturing Company v. G. D. Bair, supra; Complete Auto Transit, Inc. v. Brady, supra.*

A. The Washington B&O Tax Discriminates Against Interstate Commerce Because It Imposes A Greater Tax Burden On Interstate Transactions Than It Imposes On The Same Kinds Of Transactions Occurring Entirely Within The State Of Washington.

A state may not impose a tax that discriminates against interstate commerce by providing a direct commercial advantage to a local business. *Armco, Inc. v. Hardesty,* 467 U.S. 638 (1984); *Maryland v. Louisiana,* 451 U.S. 725 (1981).

In *Armco,* the Court held that a gross receipts tax imposed by the State of West Virginia unconstitutionally discriminated against interstate commerce. The seller in *Armco* was an Ohio corporation that sold its products in West Virginia. 467 U.S. at

638. West Virginia imposed a wholesaling tax at the rate of 0.27% on seller's gross receipts from sales in West Virginia. *Id.* and n. 2. Sellers who manufactured their products in-state were exempt from the wholesaling tax, and paid only an 0.88% manufacturing tax on the value of their manufactured products. 467 U.S. at , 104 S. Ct. at 2622 and n. 3 and 5. The seller in *Armco* contested the constitutionality of the West Virginia tax on the ground, *inter alia,* that the tax discriminated against interstate commerce because it exempted local manufacturers from the wholesale tax. 467 U.S. at , 104 S. Ct. at 2622.

The Court held that the West Virginia gross receipts tax taxed interstate transactions more heavily than it taxed transactions that occurred entirely within the State, and was unconstitutional, because out-of-state manufacturers were subject to a tax (the 0.27% wholesaling tax) from which in-state manufacturers were exempt. 467 U.S. at , 104 S. Ct. at 2622-2623. Although West Virginia manufacturers actually paid a higher rate of tax (the 0.88% manufacturing tax) than did taxpayers selling products in West Virginia that were manufactured elsewhere (the 0.27% wholesaling tax), the Court held that the higher manufacturing tax imposed on in-state sellers did not also include or compensate for a tax on their in-state wholesaling activities, despite the fact that manufacturing frequently entails selling in the state, because the in-state sellers did not pay a reduced tax on their out-of-state sales. 467 U.S. at , 104 S. Ct. at 2623.

The Court illustrated the discriminatory effect of the West Virginia gross receipts tax on interstate commerce by analyzing the tax burden on a seller operating in two hypothetical states with the same gross receipts tax system: a wholly in-state seller would pay a maximum tax of 0.88%, whereas an interstate seller would have to pay a total tax of 1.15% (0.88% in one state plus 0.27% in the other). 467 U.S. at , 104 S. Ct. at 2623-2624.

The Washington B&O tax is similar to the West Virginia gross receipts tax struck down in *Armco,* because it taxes local sellers

only once when they conduct both manufacturing and wholesaling activities in-state, whereas interstate sellers are taxed at the same rate when they conduct only one activity: wholesaling.[13] Indeed, in its opinion in *Armco,* the court noted that the two taxes were similar. 467 U.S. at , 104 S. Ct. at 2623, citing Justice Goldberg's dissent in *General Motors v. Washington, supra.* 377 U.S. at 459.

The Washington B&O tax is more discriminatory than the West Virginia gross receipts, because it taxes extraction of raw materials, as well as manufacturing and wholesaling, all at the same rate of 0.44%, with in-state sellers paying the tax but once. Thus, using the Court's analysis set out in *Armco,* a wholly in-state seller who extracts, manufactures, and sells in Washington would pay a maximum tax of only 0.44%, whereas an interstate seller who manufactures elsewhere would pay a total tax of 0.88% (1.32% if the seller extracted elsewhere as well).

The problem is that Washington provides local manufacturers with an exemption in Section 82.04.440, which is not available to out-of-state sellers. In *Maryland v. Louisiana, supra,* the Court has held a taxing system that provided similar benefits for in-state residents violated the Commerce Clause. In *Maryland v. Louisiana,* the Court invalidated a Louisiana first use tax of 7¢ per MCF on gas imported into Louisiana for processing, because tax credits and exclusions were available on much of the gas that remained in Louisiana, which credits and exclusions were not available to gas transported out-of-state. A system of benefits to

[13]Washington taxes the wholesaler and exempts the local manufacturer, whereas West Virginia taxed the local manufacturer but exempted his local sales. Wash. Rev. Code § 82.04.440, J.S. G-5. Also, Washington taxes manufacturing and wholesaling at the same, not differing, rates. Cf. Wash. Rev. Code § 82.04.240, J.S. G-3 to Wash. Rev. Code § 82.04.270, J.S. p. G-4.

[14]The State of Washington, on page 1 of its *amicus curiae* brief filed in that case, described the West Virginia tax as "very similar" to the Washington B&O tax.

local sellers, the Court concluded, unquestionably discriminates against interstate commerce in favor of local interests. 451 U.S. at 756.

The Washington Supreme Court, in its opinion upholding the Washington B&O tax, did not deal directly with the Court's decision in *Armco,* preferring instead to see the Court's earlier decision in *General Motors* as dispositive, J.S. D-4 through D-5 and D-12, notwithstanding that *General Motors* did not deal with the issue of discrimination against interstate commerce and notwithstanding that the Court in *Armco,* 467 U.S. at , 104 S. Ct. at 2623, cited Justice Goldberg's *General Motors* dissent for the proposition that the Washington B&O tax suffered the same unconstitutional defects as did the West Virginia tax. The Washington Supreme Court also sought to distinguish *Armco* on the grounds that the State of Washington exempts local sellers from the Washington manufacturing tax, whereas the State of West Virginia exempted local sellers from the wholesaling tax, J.S. D-6 through D-8, notwithstanding that the effect of the exemptions in both instances has the same effect of granting local sellers a benefit not available to interstate sellers and notwithstanding that the State of Washington, in taxing all activities at the same rate, actually imposes a greater burden on interstate commerce than did the State of West Virginia.

The Washington B&O tax unconstitutionally discriminates against interstate commerce by giving preferential benefits to in-state manufacturers, and imposes an excessive burden on an interstate seller, such as Tyler Pipe. It is thus internally inconsistent and facially discriminatory and must be struck as violative of the Due Process and Commerce clauses. *Armco v. Hardesty, supra.; Maryland v. Louisiana, supra.*

B. The Washington B&O Tax Does Not Fairly Apportion The Tax Burden, Because The Taxable Income and Tax Rate of A Seller Who Manufactures The

Product In-State And Extracts The Raw Materials For Such Product In-State Is Exactly The Same As That Of An Out-Of-State Seller Whose Sole In-State Activity Is Wholesaling.

C. The Washington B&O Tax Is Not Fairly Related To The Services Provided By The State, Because A Seller Whose Sole Connection With The State Of Washington Is The Wholesaling Of Products Must Pay The Same Amount Of Tax As A Seller Who Extracts Raw Materials For And Manufactures, As Well As Wholesales, The Product In-State, Notwithstanding The Fact That Extraction, Manufacturing And Wholesaling Activities Necessarily Require Greater Utilization Of Public Services Than Does Merely Wholesaling.

D. The Income Sought To Be Taxed By the State Of Washington B&O Tax Bears No Rational Relationship To The Values Of Tyler Pipe Connected With The State, Because Tyler Pipe Would Be Taxed At Exactly The Same Rate On Exactly The Same Gross Receipts If It Also Had Extracted Raw Materials And Manufactured Its Product In The State Of Washington.

An important consideration in determining whether a state may tax an interstate seller is "whether the state has given anything for which it can ask return." *State of Wisconsin v. J.C. Penney,* 311 U.S. 435 (1940).

If Tyler Pipe had engaged in sufficient wholesaling activities in the State of Washington to constitute substantial nexus for constitutional purposes, then Tyler Pipe would have utilized the services and protection of the State to a degree such that the State could ask for return from Tyler Pipe. Even so, Tyler Pipe would

have utilized such services or protections, if any, to only a small fraction of the extent as did Olympic Foundry Company, a competitor of Tyler Pipe that manufactured and sold its products in Washington. J.A. 82, 83. Yet the Washington B&O tax would require Tyler Pipe and Olympic Foundry Company to contribute equally to the support of state services.

Olympic Foundry conducted manufacturing in the State of Washington, but was exempt from the manufacturing tax and subject only to the same wholesaling tax that the State of Washington seeks to impose upon Tyler Pipe's Washington sales. Olympic Foundry thus presumably had a manufacturing facility, inventory, cash, receivables, trucks, employees and other assets located in the State of Washington. Tyler Pipe had none of these in Washington. Indeed, Tyler Pipe used interstate facilities to deliver its products to Washington customers. Tyler Pipe thus had no need for police or fire protection, nor for local utility, zoning, sanitation or other such governmental services. Except for use of the Washington Courts in this case, there is no evidence that Tyler Pipe ever used, or had need for, any State of Washington service with respect to the sales sought to be taxed. A taxing system that forces interstate businesses that use few, if any, state services and a local company that uses many state services to bear an equal share of the tax burden of providing those services is not fairly related to the services provided by the state.

With respect to sales made by the Utility Division and the DWV Division to Washington customers, Tyler Pipe's values are located in Texas where its facilities and employees are located.[15] Even if, with regard to such sales, Tyler Pipe had conducted substantial activities in the State of Washington and therefore had substantial values in the State of Washington, most (or at least much) of Tyler Pipe's values would still be located in Texas.

[15]The values of Ashe & Jones in the State of Washington were taxed by the state—see above, p. 8.

The State of Washington seeks, however, to impose its B&O tax on Tyler Pipe at the same tax rate as if all of Tyler Pipe's activities and values with respect to its Washington sales were located in the State of Washington—at the same tax rate as if Tyler Pipe were also extracting raw materials for and manufacturing its product in the State of Washington. The measure of the tax is thus not reasonably related to Tyler Pipe's contact with the State of Washington. *Commonwealth Edison Company v. Montana,* 453 U.S. 609, 610 (1981).

CONCLUSION

The decision of the Washington Supreme Court was in error because (i) Appellant Tyler Pipe has insufficient minimal connection and no substantial nexus with the State of Washington, (ii) the Washington B&O tax discriminates against interstate commerce, (iii) the Washington B&O tax is not fairly apportioned, (iv) the Washington B&O tax is not fairly related to the services provided by the State, and (v) the Washington B&O tax is not rationally related to the values of Appellant in the State. For all or any one of these reasons, the Washington B&O tax violates both the Commerce Clause and Due Process Clause, and the Court should reverse the decision of the Supreme Court of Washington.

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APPENDIX

The Federal Interstate Tax Act Provides That a Seller May Solicit Sales in a State Directly or Through an Independent Contractor Without Being Subject to Income Taxation in That State.

(1) The Federal Interstate Income Tax Act prohibits a state from taxing an enterprise whose sole activity in the state is the solicitation of sales, whether directly or through an independent contractor sales representative with an in-state office.

The Federal Interstate Income Tax Act, 15 U.S.C. §§381 to 384, J.S. G-1 through G-2, provides that no state may impose a net income tax upon a seller if the only business activities of the seller in the state are the solicitation of orders for sales of personal property. 15 U.S.C. §381(a)(1), J.S. G-1. The sales orders must be sent outside the state for acceptance and must be filled by shipment from outside the state. 15 U.S.C. §381(a)(1), J.S. G-1. The provisions of the Act do not apply, however, to sellers incorporated or domiciled in the taxing state. 15 U.S.C. §381(b), J.S. G-2.

The out-of-state seller may also engage independent contractors to solicit sales in the state without incurring state taxation. 15 U.S.C. §381(c), J.S. G-2. An independent contractor is defined for purposes of the statute as "a commission agent, broker, or other independent contractor" who solicits sales of personal property for more than one principal and who holds himself out as such. 15 U.S.C. §381(d)(1), J.S. G-2. The maintenance by the seller's independent contractors of an office in the taxing state is expressly permitted without causing the seller to be subject to state taxes. 15 U.S.C. §381(c), Jur. St. at G-2.[1]

The Federal Interstate Income Tax Act does not draw the line between taxable and nontaxable sellers, but establishes a minimum level of contact with a state that will be clearly beyond the

[1]The original proposed version of the Act provided that the seller himself may maintain an in-state sales office, but this provision was apparently dropped. *See,* S. Rep. No. 658, 86th Cong., 1st Sess. *reprinted in* 1959 U.S. Code Cong. & Ad. News at 2548, 2552 and 2553-54.

reach of the states' taxing power. S. Rep. No. 658, 86th Cong., 1st Sess. *reprinted in* 1959 U.S. Code Cong. & Ad. News, at 2554; Conf. Rep. No. 1103, 86th Cong., 1st Sess. *reprinted in* 1959 U.S. Code Cong. & Ad. News, at p. 2560. If an out-of-state seller's activities go beyond the solicitation of sales, then the seller may not utilize the safe harbor of the Act to avoid state taxation, but there still may be insufficient minimal connections and lack of substantial nexus under the Constitution with the taxing state.

(2) Because the Washington B&O tax is a *gross* receipts tax, and not just a *net* income tax, the Washington B&O tax should be reviewed according to standards even stricter than those of the Federal Interstate Income Tax Act, in accordance with the Court's past decisions and Congressional policy.

A gross receipts or gross income tax should be required to pass Constitutional muster under at least as strict a standard as that applied to net income taxes because such taxes are even more burdensome on interstate commerce than net income taxes. The Court has often pointed out that a tax on gross receipts inherently imposes a greater burden on interstate commerce than a net income tax because it creates a greater danger of multiple taxation and cumulative burdens on interstate commerce, *National Geographic Society v. Calif. Board of Equalization,* 430 U.S. 551, 557 (1977); *General Motors Corp. v. Washington,* 377 U.S. at 440, and because a gross receipts tax is imposed on the seller even if the seller realizes little or no profits and could turn a marginally profitable business into a losing venture, *Moorman Manufacturing Co. v. Barr,* 437 U.S. at 280.[2] Logically, therefore, if the standards to be applied to determine the sufficient minimal connection and substantial nexus required to justify a gross receipts or gross income tax are to differ from those applied to justify net income taxes, those standards should be much more restrictive of the states taxing powers over interstate commerce.

[2]In *Moorman,* the Court upheld imposition of a net income tax with a one factor (sales) apportionment, where a gross receipts tax on those sales would have been valid under the Constitution. 437 U.S. at 280. The seller in *Moorman* had 500 salesmen and six warehouses in the taxing state. 437 U.S. at 269.

Congress had intended, moreover, that persons engaging in interstate commerce who could not be subject to a state's net income tax under the Federal Income Tax Act, would also not be subject to the state's gross receipts taxes:

> It was the purpose of both Houses to specifically exempt from state taxation, income derived from interstate commerce where the only business activity within the State by the out-of-state company was solicitation.

Conf. Rep. No. 1103, *supra.,* at 2560-61; and *see, Heublein, Inc. v. South Carolina Tax Comm.,* 409 U.S. 275, 280 (1972).

The Federal Interstate Income Tax Act was passed by Congress in 1959 in response to the Court's decision in *Northwestern States Portland Cement v. State of Minnesota,* 358 U.S. 450 (1959), which upheld the validity of a state net income tax imposed on an out-of-state seller.[3] Senate Report No. 658, *supra.,* at p. 2549. At the time the statute was passed, gross receipts taxes imposed on out-of-state sellers were already unconstitutional "privilege taxes" under *Freeman v. Hewit,* 329 U.S. 249 (1946) and *Spector Motor Service v. O'Connor,* 340 U.S. 602 (1951). 358 U.S. at 458. The more flexible rule, which allows a state to tax out-of-state sellers if there is sufficient nexus between the state and the seller, was not applied to gross receipts taxes until *Complete Auto Transit, Inc. v. Brady, supra,* eighteen years after the Federal Interstate Income Tax Act had been passed. Congress thus did not specifically include gross receipts taxes in the cover-

[3]One seller in *Northwestern States* had a furnished sales office, two cars and several employees in the state, 358 U.S. at 454; the other seller also had a sales office and maintained an inventory in the state, 358 U.S. at 455. The Act, as passed, would not have saved either seller from state taxation. See Note 1, above.

age of the Federal Interstate Income Tax Act because states were already prohibited under the *Freeman* and *Spector Motors* cases from imposing such taxes on out-of-state sellers.

The Congressional intent to "exempt from State taxation income derived from interstate commerce . . . where the only business activity within the state . . . was solicitation" should therefore be construed in the context in which it was passed as an expression of Congressional policy that applies to gross receipts taxes as well as to net income taxes.

In light of the expressed concern of Congress that state net income taxes may impose unwarranted burdens on interstate commerce, the standards Congress established for net income taxes are worthy of consideration in determining what should constitute the minimum connection and substantial nexus required for imposition of the even more burdensome gross income taxes, particularly in light of the judicial history of gross receipts taxes.

(3) Because Tyler Pipe's sole connection with the State of Washington is the utilization of an independent contractor to solicit sales in Washington, the State of Washington would be prohibited from imposing an income tax upon Tyler Pipe under the Federal Interstate Income Tax Act.

If the Washington B&O tax were a net income tax, there would be no question but that the State of Washington could not tax Tyler Pipe under the Federal Interstate Income Tax Act. The orders for Utility Division and DWV Division products are sent to Tyler Pipe in Texas, acceptance of such orders is made by Tyler Pipe in Texas, and Tyler Pipe ships the products to the customers from Tyler, Texas. Tyler Pipe is not incorporated or domiciled in the State of Washington, and is not even qualified to do business in Washington. Tyler Pipe's sales representative in Washington

State, Ashe & Jones, is an independent contractor under the Act because it is compensated on a commission basis, solicits sales for other sellers and holds itself out as a commissioned manufacturer's representative. The only activities of Tyler Pipe and its independent contractor sales representative in the State of Washington are the solicitation of sales, which are specifically inadequate grounds under the Act for state taxation.

CERTIFICATE OF SERVICE

It is hereby certified that service of the foregoing Brief of Appellant was made this day of November, 1986, upon all parties required to be served by depositing three copies thereof in the United States Mail, first class postage prepaid, addressed:

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